

INTERMEDIATE (IPC) COURSE

STUDY MATERIAL

PAPER : 4

TAXATION

Part – 1 : Income-tax

Assessment Year 2015-16

(As amended by the Finance (No. 2) Act, 2014)

MODULE – 1



BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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A WORD ABOUT STUDY MATERIAL

In the syllabus for Chartered Accountancy course, taxation constitutes a core competence area for the students. A thorough knowledge of taxation helps the students to increase their analytical abilities. In the Intermediate (IPC) Course, "Taxation" constitutes Paper 4. Students are expected to acquire working knowledge in, *inter alia*, income-tax after undergoing this course.

The Study Material explains the provisions of income-tax and the Practice Manual contains the questions on income-tax from past examinations, adapted and solved on the basis of the provisions applicable for A.Y.2015-16. The subject matter in the Study Material is based on the law as amended by the Finance (No. 2) Act, 2014 and relevant for A.Y.2015-16. Efforts have been made to present the complex law of income-tax in a lucid manner. Care has been taken to present the chapters in a logical sequence to facilitate easy understanding by the students. The various illustrations will help in understanding the application of income-tax law and stimulate analytical thinking by the students.

The main features of this edition of the Study Material are -

- The amendments made by the Finance (No. 2) Act, 2014 and incorporated in this study material have been tabulated chapter-wise with the corresponding section reference and given as "Significant Amendments in this Edition" in the next three pages.
- In the Study Material, the latest amendments i.e., the amendments made by the Finance (No.2) Act, 2014 and notifications and circulars issued between 01.05.2013 and 30.04.2014 have been given in ***bold and italics***.
- The new illustrations as well as the illustrations which have undergone changes due to these amendments have been given in a shaded background.
- Feedback form is given at the end of the Study Material. The students are encouraged to give their feedback/suggestions.

These features would aid the students in the learning process. Finally, we would welcome suggestions to make this book more helpful and 'student-friendly'. In case you need any further clarification/guidance, you may send your queries at priya@icai.in or aparna.chauhan@icai.in

TAXATION

PART I : INCOME TAX

AMENDMENTS AT A GLANCE – FINANCE (No.2) ACT, 2014

Particulars	Section
Chapter 1: Basic Concepts	
Rates of income-tax	
Chapter 3: Incomes which do not form part of total income	
Registered trusts and institutions which are eligible for exemption under sections 11 to 13 not allowed to claim exemption under any of the clauses of section 10, other than exemption available under clauses (1) and (23C) of section 10	11(7) & 10(23C)
Disallowance of depreciation on commercial lines in respect of a capital asset, cost of acquisition of which has been claimed as application of income	11 & 10(23C)
Meaning of "Substantially financed by the Government" for the purpose of exemption under sub-clauses (iiiab) and (iiiac) of section 10(23C)	10(23C)
Power of Principal Commissioner/Commissioner to cancel registration of trust or institution expanded	12AA
Taxability of anonymous donations exempt from applicability of maximum marginal rate of tax	115BBC
Registration granted to trust or institution to also be applicable to earlier years in specific cases	12A
Chapter 4 Unit 2: Income from house property	
Increase in deduction for interest on loan borrowed for acquisition or construction of self-occupied house property	24(b)
Chapter 4 Unit 3: Profits and gains of business or profession	
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Capital asset in respect of which deduction under section 35AD has been claimed to be used for "specified business" for a period of eight years	35AD
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Expansion of scope of section 40(a)(ia) to cover all expenditure/payments on which tax is deductible under Chapter XVII-B and restriction of quantum of disallowance thereunder to 30% of sum paid	40(a)(ia)
Speculative transaction to exclude eligible transaction in respect of trading in commodity derivatives carried out in a recognised association, which is chargeable to commodities transaction tax (CTT)	43(5)
Uniform amount of presumptive income from each goods carriage, whether heavy goods vehicle or other than heavy goods vehicle	44AE
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Chapter 4 Unit 5: Income from other sources	
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Chapter 6: Set-off and Carry Forward of Losses	
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STUDY PLAN – KEY TO EFFECTIVE LEARNING

Part – I: Income-tax

Income-tax is a direct tax i.e., it is a tax levied directly on the income of a person. Income-tax, at the Intermediate (IPC) level, largely involves application of provisions of the Income-tax Act, 1961 to solve computational problems. It is, therefore, very interesting and at the same time, a dynamic subject, on account of the major changes which take place in the income-tax law every year.

Since the subject of income-tax is new to you, it is essential that you need to have an idea of the constituents or elements which make up the income-tax law. You also need to understand the basic concepts, especially, the concept of "income", on which tax is levied under this Act. The concepts of "assessment year" and "previous year" are equally imperative. Most importantly, you need to comprehend the manner of computation of total income, on which income-tax is levied.

Know your syllabus and expected level of knowledge

It is important that you are aware of the scope of syllabus and the level of knowledge expected, so that you can plan your study accordingly.

The syllabus of Part – I: Income-tax of IPCC Paper 4 : Taxation comprises of –

- Important definitions in the Income-tax Act, 1961,
- Basis of charge, rates of taxes applicable for different types of assessees,
- Concepts of previous year and assessment year,
- Residential status and scope of total income,
- Incomes which do not form part of total income,
- Heads of income and the provisions governing computation of income under different heads,
- Income of other persons included in assessee's total income,
- Aggregation of income, set-off or carry forward and set-off of losses,
- Deductions from gross total income,
- Computation of total income and tax liability; rebates and reliefs,
- Provisions concerning advance tax and tax deduction at source and
- Provisions for filing return of income.

Working knowledge of the above topics is required at the IPCC level.

You are expected to gain knowledge of the provisions of income-tax law related to the topics mentioned above and also gain ability to solve simple problems concerning assessees with the status of individual covering the areas mentioned in the above paragraph.

Be informed of the Finance Act and Assessment Year relevant for your examination

The Finance Act of a particular year would be applicable for the May and November examinations of the next year. For instance, the amendments made by the Finance (No. 2) Act, 2014 would be applicable for May, 2015 and November 2015 examinations. The relevant assessment year for May 2015 and November 2015 examinations is, therefore, A.Y.2015-16.

You are expected to be updated with the notifications, circulars and other legislative amendments made upto 6 months prior to the examination. For May 2015 examination, such amendments made upto 31st October, 2014 would be relevant and for November 2015 examination, such amendments made upto 30th April, 2015 would be relevant.

Draw up a detailed study plan and allocate time for each topic/chapter of the subject

Preparing a comprehensive study time table well in advance would be of great help in organizing your study in an effective manner. In fact, you should start your study immediately after passing your CPT examination and registering for Intermediate (IPC) Course. Ideally, you should allocate at least 3 to 4 hours every day for the subject of income-tax. Utilise your study period effectively.

The next step is to estimate the time to be allocated for each topic/chapter of the subject. The scope of syllabus, the contents of each chapter in the Study Material and Practice Manual would help you to broadly assess the time which each topic of the subject would consume. Of course, since the subject of income-tax is new to you, you have to keep some percentage margin over and above the time assessed by you to take care of possible difficulty in understanding new concepts, particularly relating to business taxation, capital gains and provisions concerning deduction of tax at source.

Make full use of all the knowledge inputs of BOS

The Board of Studies brings out various publications from time to time with a view to assist the students in education. You are advised to make full use of the Study Material and other educational inputs provided to you. These educational inputs are also hosted at the Student Home Page of ICAI <http://students.icai.org>. The intention of creation of this portal is primarily to ensure free and unrestricted flow of knowledge and information to the students across the country by way of easy access to the latest publications of the Institute. Our efforts will, however, bear fruit only if you make it a habit to browse the portal as often as possible and assimilate the knowledge inputs contained therein. It is of utmost importance that you read these knowledge inputs to attain conceptual clarity, to remain updated with the developments in all the subjects and also to acquire the ability to apply the concepts to solve computational problems. Some of the important publications of BOS in the area of Income-tax are -

Publication	Objective	Key Features
Study Material	The aim of the Study Material is to build a strong conceptual base by explaining the	<ul style="list-style-type: none">• The chapters are organised in a logical sequence for clear comprehension;• The provisions of income-tax law have been explained in a lucid manner to

	complex income-tax law in an easy way.	<p>facilitate easy understanding;</p> <ul style="list-style-type: none"> • Illustrations have been given, wherever possible, to explain the provisions of income-tax law; • The latest amendments have been given in bold and italics; • The Circulars/Notifications issued by the CBDT have been discussed along with the respective sections to which they relate.
Supplementary Study Paper	This is a very important knowledge input in the area of taxation explaining the amendments made by the relevant Finance Act and latest circulars and notifications issued by CBDT.	<ul style="list-style-type: none"> • The Supplementary Study Paper is also divided into chapters, so that you can co-relate the same with the Study Material; • Illustrations have been given, wherever possible, for better understanding of the amendments; • Related sections are grouped together and explained to facilitate interlinking and reading of interconnected provisions; • In respect of each notification, the relevant provision of the Act which confers the power to issue such notification is described briefly, so that you can relate the notification to the appropriate provisions of the Act.
Practice Manual	The Practice Manual has also been grouped chapter-wise and contains a variety of problems in each topic for the better understanding and application of the concepts explained in the Study Material.	<ul style="list-style-type: none"> • The questions in each chapter of the Practice Manual are taken from the past twelve years question papers set at the PE-II, PCC and IPCC examinations. In addition, other questions from past RTPs etc. are also included; • The questions are adapted as per the provisions of income-tax law as amended by the latest relevant Finance Act. • Answers to the questions are based on the provisions of income-tax law as amended by the latest relevant Finance Act.

		<p>For example, in the October 2014 edition of the Practice Manual, the questions and answers are based on the provisions of income-tax law as amended by the Finance (No. 2) Act, 2014 and are hence, relevant for May 2015 and November 2015 examinations. The relevant assessment year is A.Y.2015-16.</p> <ul style="list-style-type: none"> • Key points are given at the beginning of each chapter to facilitate quick revision; • Self-examination questions are added at the end of each chapter to test your understanding of the concepts explained in the corresponding chapter of the Study Material.
Revision Test Papers (RTP)	<p>The RTPs are prepared with the twin objective of –</p> <ol style="list-style-type: none"> (1) updating you on the latest developments on the statutory front. (2) helping you to self-assess the effectiveness of your study and revision by solving the questions given in Part II independently and comparing the same with the answers given. 	<ul style="list-style-type: none"> • The RTP is divided into two parts – Part I : Statutory Update – Latest Notifications & Circulars Part II : Questions & Answers - A Self-assessment test. • The questions in Part II are framed to test your awareness and understanding of the provisions of income-tax law forming part of the syllabus for Intermediate (IPC) Course.
Suggested Answers	<p>As the name depicts, this publication contains the questions set at the CA examination, as well as the suggested answers to such questions.</p>	<ul style="list-style-type: none"> • The answers are prepared with a view to assist the students in education; • The Suggested Answers generally represent the ideal manner in which questions should be answered; • Therefore, it contains references to sections (including sub-sections and clauses), notifications and circulars issued by the CBDT;

		<ul style="list-style-type: none"> In solutions to computational problems, the reasons for treatment of items are explained by way of Notes, giving reference to the related provisions of income-tax law.
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Follow systematic study pattern

Ideally, for the subject of Income-tax, your study pattern should be in the following sequence as briefed in the table below -

Steps in Preparation	Objective of study	Relevant Publication
Step I	Study each topic of your syllabus thoroughly for conceptual clarity	Study Material as amended by the Finance Act relevant for your examination.
Step II	Understand the latest developments on the statutory front, i.e., the amendments made by the latest Finance Act and recent Notifications and Circulars issued by CBDT.	Supplementary Study Paper
Step III	Work out the problems and solve the questions after completing study of each chapter in the Study Material to test your level of understanding of concepts explained in the said chapter. Note – After you complete study of the entire syllabus content, solve all the problems in the Practice Manual once again to make sure there are no grey areas.	Practice Manual
Step IV	Update yourself with the latest developments on the statutory front, i.e., significant notifications and circulars issued six months prior to the respective examination, and self-assess your preparation.	Revision Test Paper (RTP)
Step V	Test your level of preparation by solving past question papers within the given time frame of three hours and compare your answers with the answers published by the BOS. You can also check your progress by solving the Mock Test Papers hosted on the Students' Home Page. Mock tests are also held at the various regional offices and branches of the Institute.	Suggested Answers Mock Test Papers

Step I – Study the “Study Material” to get your concepts clear

Ideally, when you take up any topic for study, you must first go through the relevant chapter of the Study Material for building a strong conceptual base. Make sure you read the Study Material updated on the basis of the provisions of income-tax law as amended by the Finance Act relevant for your examination. In case you have the earlier edition of the Study Material, then, you must go through the Supplementary Study Paper, which explains the amendments made by the Finance Act relevant for your examination.

Step II – Stay current with the “Supplementary”

You are advised to update yourself with the help of Supplementary Study Paper which is brought out every year. In this publication, the amendments made in income-tax law by the Finance Act of that year are categorized chapter-wise and explained with the aid of illustrations and tabular presentations to facilitate easy understanding. Further, the latest notifications and circulars issued by the CBDT (up to 30th April of the year) are also explained in the Supplementary Study Paper. Accordingly, the Supplementary Study Paper-2014 explains the amendments made by the Finance (No. 2) Act, 2014 and significant notifications and circulars issued between 01.05.2013 and 30.4.2014.

You must carefully peruse the amendments explained in the Supplementary Study Paper and update yourself. The related sections are grouped together and discussed at one place in the Supplementary Study Paper and therefore, you would not face any difficulty in combined reading and understanding of the interconnected provisions.

Even if you have the latest Study Material, we would still advise you to go through the Supplementary Study Paper, since the amendments are discussed in detail therein. It would also help you understand and assimilate the recent amendments in a more effective manner.

Step III – Apply the concepts to solve practical problems in the Practice Manual

After reading each chapter in the Study Material, try to work out the problems in the parallel chapter of the Practice Manual on your own, and thereafter compare your answers with the answers given therein. This would help you to identify your mistakes and also learn from your mistakes. Further, this process would help in revision of the concepts and principles contained in each chapter of the Study Material and application of the same while solving computation problems. The computation problems in the Practice Manual are worked out in detail, with working notes/notes, giving reference to the related provisions of income-tax law.

Once you complete study of all the topics in the syllabus, try solving the problems in the Practice Manual once again to test if you are clear with all the concepts or whether there are still any grey areas which require further understanding.

Step IV – Update & Revise with the aid of the RTP

Update yourself on the statutory front

The Study Material is generally updated on the basis of the Finance Act of that year and notifications and circulars issued up to 30th April of that year. The Study Material, so updated, would be relevant for May and November examinations held in the following year. However, for the May examination to be held in the following year, the significant notifications and circulars issued upto 31st October of the previous year are relevant. The RTP for May examination,

therefore, contains the significant notifications and circulars issued between 1st May and 31st October of the previous year. Likewise, for the November examination of the following year, the significant notifications and circulars issued upto 30th April of that year are relevant. The RTP for November examination would, therefore, contain the significant circulars and notifications issued between 1st May of the previous year and 30th April of the next year.

For instance, the October, 2014 of the Study Material is updated on the basis of the amendments made by the Finance (No. 2) Act, 2014 and circulars and notifications issued upto 30th April, 2014. This edition of the Study Material is relevant for May 2015 and November 2015 examinations. However, for May 2015 examination, the amendments made by circulars and notifications issued between 1st May, 2014 and 31st October, 2014 are also relevant, and hence, the same would be explained in the RTP for May 2015 examination. Likewise, for November 2015 examination, the amendments made by circulars and notifications issued between 1st May, 2014 and 30th April, 2015 would also be relevant, and the same would be given in the RTP for November 2015 examination.

Revise what you have learnt

Solving the questions and problems in the Revision Test Papers and comparing the same with the answers given would help you to self-assess the effectiveness of your study and revision.

Step V - Check your level of preparation

Solve past years' question papers and compare with Suggested Answers

You should also make an honest attempt to solve the immediately preceding examination papers within a time span of three hours and compare your answers with the Suggested Answers published by the Board of Studies. This will help you to identify the areas where you are deficient and enable you to take corrective steps to avoid such mistakes in your examination.

However, remember that Suggested Answers are prepared on the basis of the provisions applicable for the assessment year relevant for that particular examination. For example, the Suggested Answers for May 2014 examination are based on the provisions applicable for A.Y.2014-15. In case you are appearing for the examination in May 2015 or November 2015, the relevant assessment year would be A.Y.2015-16. Therefore, while checking your answers with the answers given in the Suggested Answers, you should keep in mind that your answer would vary to the extent of amendments made by the Finance (No.2) Act, 2014 and notifications and circulars issued after 31.10.2013.

Solve Mock Test Papers

You may also try attempting Mock Test Papers hosted on the Students' Home Page of ICAI to complete the process of revision. You can also appear for the Mock Tests conducted at the regional offices and branches of the Institute and check your level of progress.

Face the examination with confidence

Having prepared well for the examination, it is also important that you approach the examination with a positive attitude. Do keep in mind the following points to score well in this paper –

- (i) **Answer the questions with due emphasis on provisions of income-tax law** - Support your answers/conclusions with proper reasoning. Answers should be based on relevant legal provisions rather than a mere common sense and/or guess work.
- (ii) **Supplement your computation with Working Notes** - Give complete working notes while solving computational problems.
For example, if you are computing taxable HRA while calculating salary income, the working note should specify the three limits and the corresponding figures, the least of which would be exempt under section 10(13A). The balance HRA would be taxable and taken to the main computation sheet.
- (iii) **Try to quote relevant section numbers** – Quoting section numbers would definitely add value to your answers. However, it is better not to quote than to misquote a section number.
- (iv) **State your assumptions/views clearly** - The provisions of income-tax law are subject to different interpretations, and hence there is a possibility of alternate views in the tax treatment of a particular item of income or expense or loss or deduction. As a student, you should state your view/assumption clearly and proceed to answer the question on that basis.
- (v) **Avoid using short forms** – Use of short forms like AO, ITO, IT Act, etc. should be avoided. Write the full names of the statutes, like, "Income-tax Act, 1961".
- (vi) **Present your answers well** - Underline important points and section references as and when you answer each question. Also, make sure that your handwriting is neat and legible. Answer all parts of a question one after the other. Do not answer different parts of the same question at different places.

Happy Reading and Best Wishes!

SYLLABUS

PAPER – 4 : TAXATION

(One paper — Three hours – 100 Marks)

Level of Knowledge: Working knowledge

Objectives:

- (a) To gain knowledge of the provisions of Income-tax law relating to the topics mentioned in the contents below and
- (b) To gain ability to solve simple problems concerning assessee's with the status of 'Individual' covering the areas mentioned in the contents below.

Contents:

PART – I : INCOME TAX (50 MARKS)

1. Important definitions in the Income-tax Act, 1961
2. Basis of charge; Rates of taxes applicable for different types of assessee's
3. Concepts of previous year and assessment year
4. Residential status and scope of total income; Income deemed to be received / deemed to accrue or arise in India
5. Incomes which do not form part of total income
6. Heads of income and the provisions governing computation of income under different heads
7. Income of other persons included in assessee's total income
8. Aggregation of income; Set-off or carry forward and set-off of losses
9. Deductions from gross total income
10. Computation of total income and tax payable; Rebates and reliefs
11. Provisions concerning advance tax and tax deducted at source
12. Provisions for filing of return of income.

The syllabus of Part II (50 Marks) is given in Volume-III of the Study Material.

Note: If new legislations are enacted in place of the existing legislations the syllabus will accordingly include the corresponding provisions of such new legislations in the place of the existing legislations with effect from the date to be notified by the Institute. Students shall not be examined with reference to any particular State VAT Law.

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Chapter 2 : Residence and Scope of Total Income

Chapter 3 : Incomes Which Do Not Form Part of Total Income

MODULE – II

Chapter 4 : Heads of Income

MODULE – III

Chapter 5 : Income of other Persons Included in Assessee's Total Income

Chapter 6 : Aggregation of Income, Set-off and Carry Forward of Losses

Chapter 7 : Deductions from Gross Total Income

Chapter 8 : Computation of Total Income and Tax Payable

Chapter 9 : Provisions Concerning Advance Tax and Tax Deducted at Source

Chapter 10 : Provisions for Filing of Return of Income

DETAILED CONTENTS: MODULE – 1

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5.	Exemption for Voluntary Contributions received by Electoral Trusts [Section 13B]	3.94

1

Basic Concepts

UNIT 1 : INCOME TAX LAW : AN INTRODUCTION

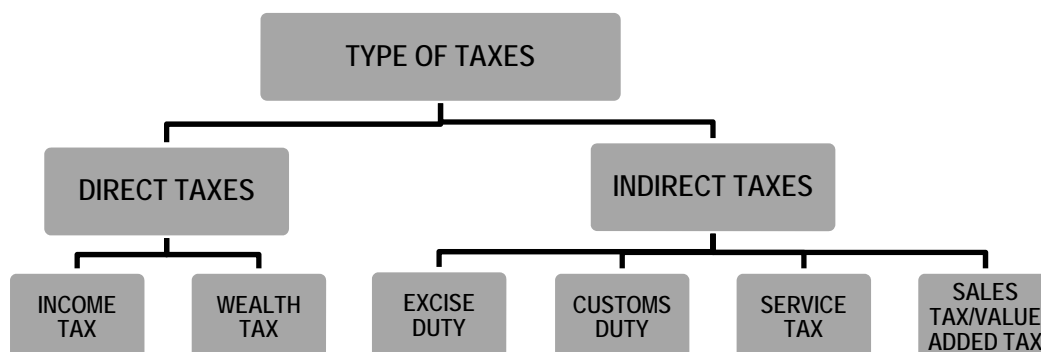
Learning Objectives

After studying this unit, you would be able to -

- ◆ understand the meaning of tax
- ◆ recognize the types of taxes
- ◆ comprehend the reason for levy of taxes
- ◆ know the components of income-tax law
- ◆ grasp the concept of income
- ◆ understand the procedure for computation of total income for the purpose of levy of income-tax
- ◆ know that there is a requirement of paying advance tax and deduction of tax at source
- ◆ appreciate what a "Return of income" means

1.1 What is a Tax?

Let us begin by understanding the meaning of tax. Tax is a fee charged by a government on a product, income or activity. There are two types of taxes – direct taxes and indirect taxes (See Chart below this paragraph). If tax is levied directly on the income or wealth of a person, then it is a direct tax e.g. income-tax. If tax is levied on the price of a good or service, then it is called an indirect tax e.g. excise duty. In the case of indirect taxes, the person paying the tax passes on the incidence to another person.

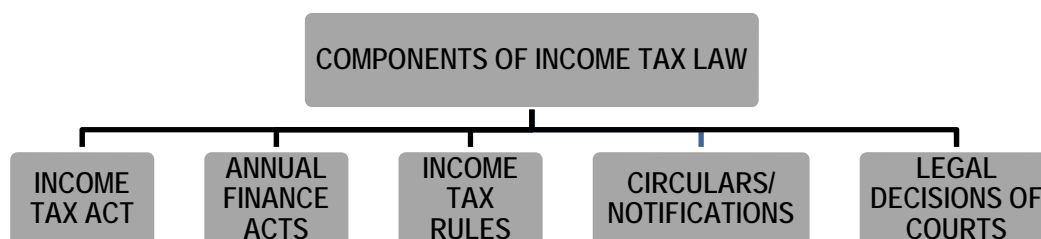


1.2 Why are Taxes Levied?

The reason for levy of taxes is that they constitute the basic source of revenue to the government. Revenue so raised is utilized for meeting the expenses of government like defence, provision of education, health-care, infrastructure facilities like roads, dams etc.

1.3 Overview of Income-Tax Law in India

Income-tax is the most significant direct tax. In this material, we would be introducing the students to the Income-tax law in India. The income-tax law in India consists of the following components–



The various instruments of law containing the law relating to income-tax are explained below:

Income-tax Act, 1961: The levy of income-tax in India is governed by the Income-tax Act, 1961. In this book we shall briefly refer to this as the Act. This Act came into force on 1st April, 1962. The Act contains 298 sections and XIV schedules. These undergo change every year with additions and deletions brought about by the annual Finance Act passed by Parliament. In pursuance of the power given by the Income-tax Act, 1961 rules have been framed to facilitate proper administration of the Income-tax Act, 1961.

The Finance Act: Every year, the Finance Minister of the Government of India introduces the Finance Bill in the Parliament's Budget Session. When the Finance Bill is passed by both the houses of the Parliament and gets the assent of the President, it becomes the Finance Act. Amendments are made every year to the Income-tax Act, 1961 and other tax laws by the Finance Act.

The First Schedule to the Finance Act contains four parts which specify the rates of tax -

- Part I of the First Schedule to the Finance Act specifies the rates of tax applicable for the current Assessment Year.
- Part II specifies the rates at which tax is deductible at source for the current Financial Year.
- Part III gives the rates for calculating income-tax for deducting tax from income chargeable under the head "Salaries" and computation of advance tax.
- Part IV gives the rules for computing net agricultural income.

Income-tax Rules: The administration of direct taxes is looked after by the Central Board of Direct Taxes (CBDT). The CBDT is empowered to make rules for carrying out the purposes of the Act. For the proper administration of the Income-tax Act, 1961, the CBDT frames rules from time to time. These rules are collectively called Income-tax Rules, 1962. It is important to keep in mind that along with the Income-tax Act, 1961, these rules should also be studied.

Circulars and Notifications: Circulars are issued by the CBDT from time to time to deal with certain specific problems and to clarify doubts regarding the scope and meaning of the provisions. These circulars are issued for the guidance of the officers and/or assessees. The department is bound by the circulars. While such circulars are not binding on the assessees, they can take advantage of beneficial circulars.

Notifications are issued by the Central Government to give effect to the provisions of the Act. For example, under section 10(15)(iv)(h), interest payable by any public sector company in respect of such bonds or debentures and subject to such conditions as the Central Government may, by notification in the Official Gazette, specify in this behalf would be exempt. Therefore, the bonds and debentures, interest on which would qualify for exemption under this section are specified by the Central Government through Notifications.

The CBDT is also empowered to make and amend rules for the purposes of the Act by issue of notifications. For example, under section 35CCD, the CBDT is empowered to prescribe guidelines for notification of skill development project. Accordingly, the CBDT has, *vide* Notification No.54/2013 dated 15.7.2013, prescribed Rule 6AAF laying down the guidelines and conditions for approval of skill development project under section 35CCD. .

Case Laws: The study of case laws is an important and unavoidable part of the study of income-tax law. It is not possible for Parliament to conceive and provide for all possible issues that may arise in the implementation of any Act. Hence the judiciary will hear the disputes between the assessees and the department and give decisions on various issues. The Supreme Court is the Apex Court of the country and the law laid down by the Supreme Court is the law of the land. The decisions given by various High Courts will apply in the respective states in which such High Courts have jurisdiction.

1.4 Levy of Income-Tax

Income-tax is a tax levied on the total income of the previous year of every person. A person includes an individual, Hindu Undivided Family (HUF), Association of Persons (AOP), Body of Individuals (BOI), a firm, a company etc.

1.5 Concept of Income

The definition of income as per the Income-tax Act, 1961 begins with the words "Income includes". Therefore, it is an inclusive definition and not an exhaustive one. Such a definition does not confine the scope of income but leaves room for more inclusions within the ambit of the term. Certain important principles relating to income are enumerated below -

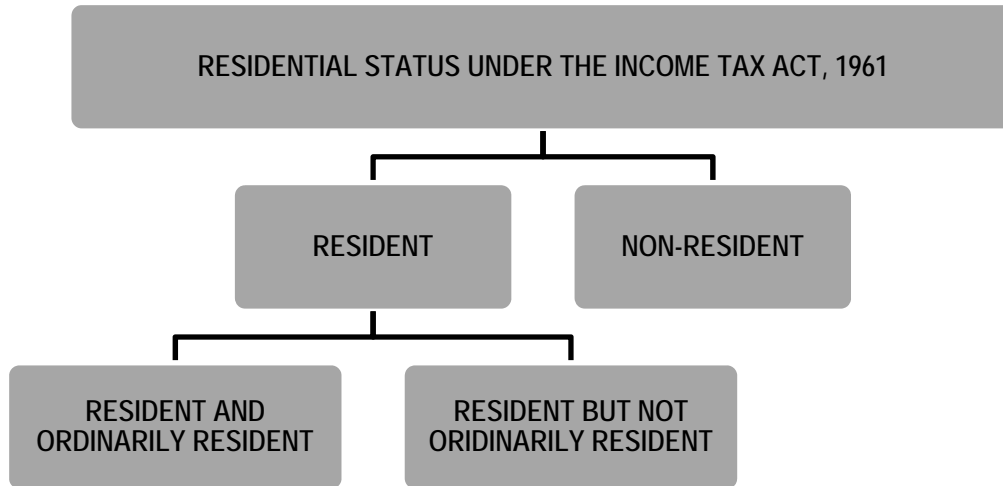
- Income, in general, means a periodic monetary return which accrues or is expected to accrue regularly from definite sources. However, under the Income-tax Act, 1961, even certain income which do not arise regularly are treated as income for tax purposes e.g. Winnings from lotteries, crossword puzzles.
- Income normally refers to revenue receipts. Capital receipts are generally not included within the scope of income. However, the Income-tax Act, 1961 has specifically included certain capital receipts within the definition of income e.g. Capital gains i.e. gains on sale of a capital asset like land.
- Income means net receipts and not gross receipts. Net receipts are arrived at after deducting the expenditure incurred in connection with earning such receipts. The expenditure which can be deducted while computing income under each head [For knowing about heads of income, see step 2 of para 1.6 below] is prescribed under the Income-tax Act.
- Income is taxable either on due basis or receipt basis. For computing income under the heads "Profits and gains of business or profession" and "Income from other sources", the method of accounting regularly employed by the assessee should be considered, which can be either cash system or mercantile system.
- Income earned in a previous year is chargeable to tax in the assessment year. Previous year is the financial year, ending on 31st March, in which income has accrued/ received. Assessment year is the financial year (ending on 31st March) following the previous year. The income of the previous year is assessed during the assessment year following the previous year. For instance, income of previous year 2014-15 is assessed during 2015-16. Therefore, 2015-16 is the assessment year for assessment of income of the previous year 2014-15.

1.6 Total Income and Tax Payable

Income-tax is levied on an assessee's total income. Such total income has to be computed as per the provisions contained in the Income-tax Act, 1961. Let us go step by step to understand the procedure of computation of total income for the purpose of levy of income-tax –

Step 1 – Determination of residential status: The residential status of a person has to be determined to ascertain which income is to be included in computing the total income.

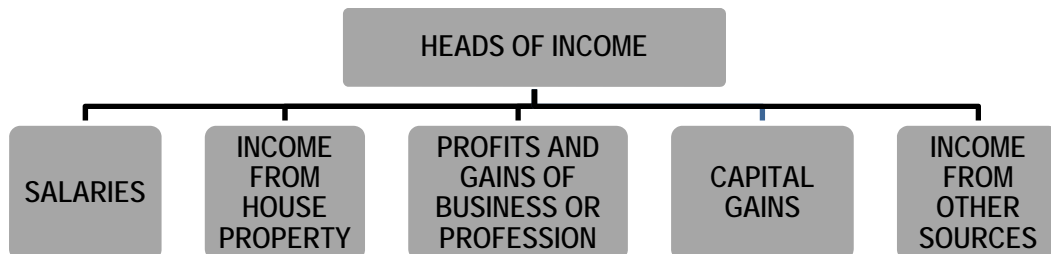
The residential statuses as per the Income-tax Act are shown below –



In the case of an individual, the duration for which he is present in India determines his residential status. Based on the time spent by him, he may be (a) resident and ordinarily resident, (b) resident but not ordinarily resident, or (c) non-resident.

The residential status of a person determines the taxability of the income. For e.g., income earned outside India will not be taxable in the hands of a non-resident but will be taxable in case of a resident and ordinarily resident.

Step 2 – Classification of income under different heads: The Act prescribes five heads of income. These are shown below –



These heads of income exhaust all possible types of income that can accrue to or be received by the tax payer. Salary, pension earned is taxable under the head "Salaries". Rental income is taxable under the head "Income from house property". Income derived from carrying on any business or profession is taxable under the head "Profits and gains from business or profession". Profit from sale of a capital asset (like land) is taxable under the head "Capital Gains". The fifth head of income is the residuary head under which income taxable under the Act, but not falling under the first four heads, will be taxed. The tax payer has to classify the income earned under the relevant head of income.

Step 3 – Exclusion of income not chargeable to tax: There are certain income which are wholly exempt from income-tax e.g. Agricultural income. These income have to be excluded

and will not form part of Gross Total Income. Also, some incomes are partially exempt from income-tax e.g. House Rent Allowance, Education Allowance. These incomes are excluded only to the extent of the limits specified in the Act. The balance income over and above the prescribed exemption limits would enter computation of total income and have to be classified under the relevant head of income.

Step 4 – Computation of income under each head: Income is to be computed in accordance with the provisions governing a particular head of income. Under each head of income, there is a charging section which defines the scope of income chargeable under that head. There are deductions and allowances prescribed under each head of income. For example, while calculating income from house property, municipal taxes and interest on loan are allowed as deduction. Similarly, deductions and allowances are prescribed under other heads of income. These deductions etc. have to be considered before arriving at the net income chargeable under each head.

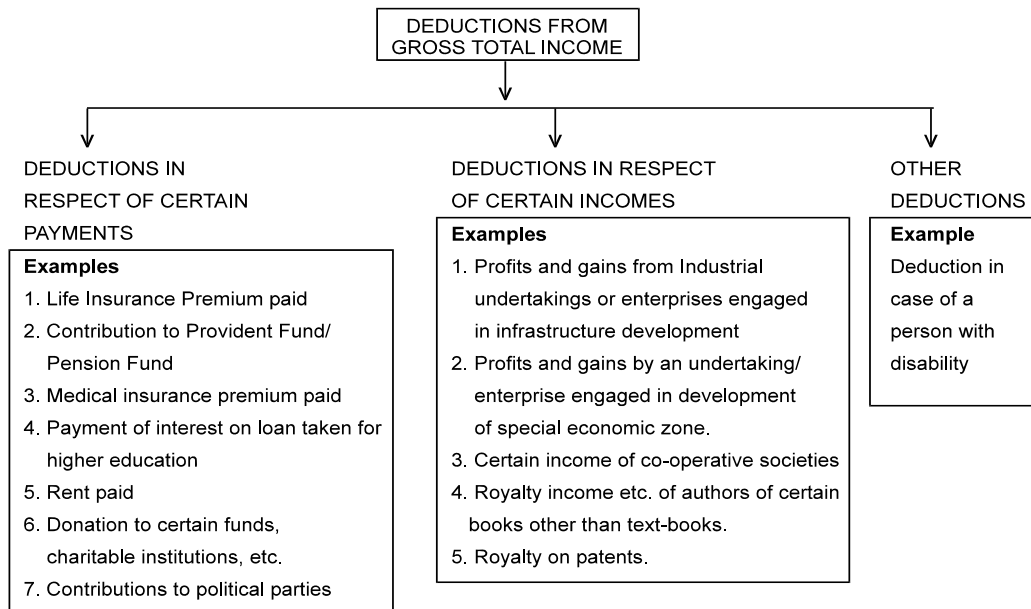
Step 5 – Clubbing of income of spouse, minor child etc.: In case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive i.e. as the income increases, the applicable rate of tax increases. Some taxpayers in the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been incorporated in the Act, under which income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person who has diverted his income for the purpose of computing tax liability.

Step 6 – Set-off or carry forward and set-off of losses: An assessee may have different sources of income under the same head of income. He might have profit from one source and loss from the other. For instance, an assessee may have profit from his textile business and loss from his printing business. This loss can be set-off against the profits of textile business to arrive at the net income chargeable under the head "Profits and gains of business or profession".

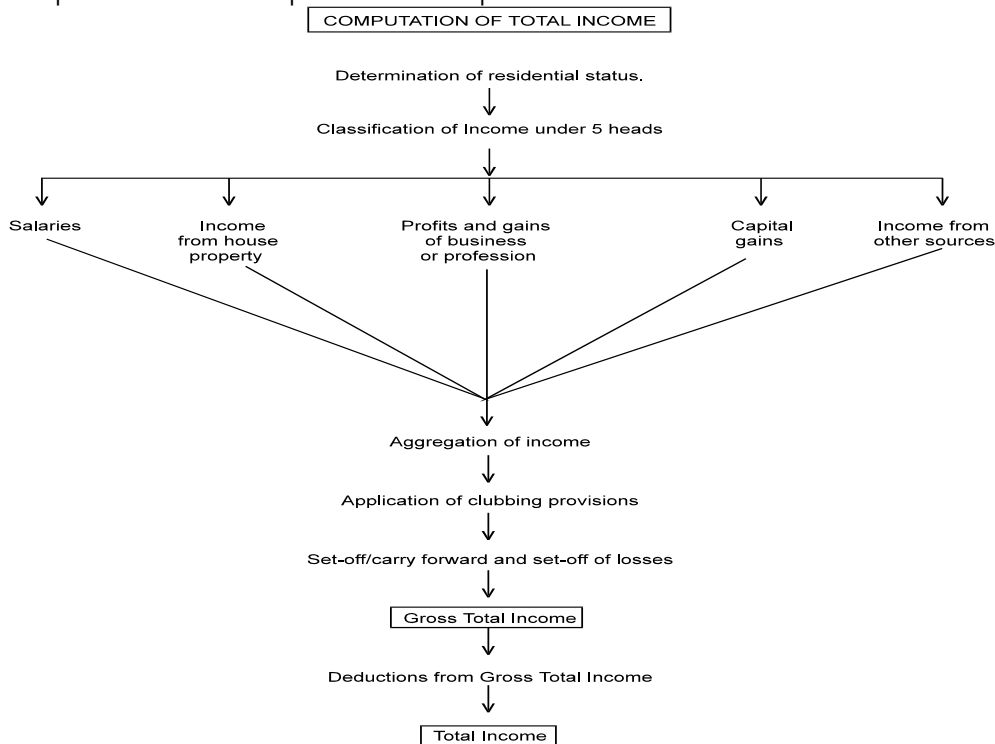
Similarly, an assessee can have loss under one head of income, say, Income from house property and profits under another head of income, say, profits and gains of business or profession. There are provisions in the Income-tax Act, 1961 for allowing inter-head adjustment in certain cases. Further, losses which cannot be set-off in the current year due to inadequacy of eligible profits can be carried forward for set-off in the subsequent years as per the provisions contained in the Act.

Step 7 – Computation of Gross Total Income: The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.

Step 8 – Deductions from Gross Total Income: There are deductions prescribed from Gross Total Income. These deductions are of three types –



Step 9 – Total income: The income arrived at, after claiming the above deductions from the Gross Total Income is known as the Total Income. It should be rounded off to the nearest multiple of ₹ 10. The process of computation of total income is shown hereunder –



Step 10 – Application of the rates of tax on the total income: The rates of tax for the different classes of assesses are prescribed by the Annual Finance Act.

For individuals, HUFs etc., there is a slab rate and basic exemption limit. At present, the basic exemption limit is ₹ 2,50,000 for individuals. This means that no tax is payable by individuals with total income of up to ₹ 2,50,000. Those individuals whose total income is more than ₹ 2,50,000 but less than ₹ 5,00,000 have to pay tax on their total income in excess of ₹ 2,50,000 @ 10% and so on. The highest rate is 30%, which is attracted in respect of income in excess of ₹ 10,00,000.

For firms and companies, a flat rate of tax is prescribed. At present, the rate is 30% on the whole of their total income.

The tax rates have to be applied on the total income to arrive at the income-tax liability.

Step 11 - Surcharge / Rebate under section 87A

Surcharge: Surcharge is an additional tax payable over and above the income-tax. Surcharge is levied as a percentage of income-tax. In case where the total income of an individual exceeds ₹ 1 crore, surcharge is payable at the rate of 10% of income-tax.

Rebate under section 87A: In order to provide tax relief to the individual tax payers who are in the 10% tax slab, section 87A provides a rebate from the tax payable by an assessee, being an individual resident in India, whose total income does not exceed ₹ 5,00,000. The rebate shall be equal to the amount of income-tax payable on the total income for any assessment year or an amount of ₹ 2,000, whichever is less.

Level of Total Income	Surcharge	Rebate u/s 87A
≤ ₹ 5,00,000	Not applicable	Income-tax on total income or ₹ 2,000, whichever is less
≥ ₹ 5,00,000 ≤ ₹ 1,00,00,000	Not applicable	Not applicable
≥ ₹ 1,00,00,000	10% of income-tax	Not applicable

Step 12 – Education cess and secondary and higher education cess on income-tax: The income-tax, as increased by the surcharge or as reduced by the rebate under section 87A, if applicable, is to be further increased by an additional surcharge called education cess@2%. The education cess on income-tax is for the purpose of providing universalized quality basic education. This is payable by all assesseees who are liable to pay income-tax irrespective of their level of total income. Further, “secondary and higher education cess on income-tax” @1% of income-tax plus surcharge, if applicable, is leviable to fulfill the commitment of the Government to provide and finance secondary and higher education.

Step 13 – Advance tax and tax deducted at source: Although the tax liability of an assessee is determined only at the end of the year, tax is required to be paid in advance in certain installments on the basis of estimated income. In certain cases, tax is required to be deducted at source from the income by the payer at the rates prescribed in the Act. Such deduction should be made either at the time of accrual or at the time of payment, as prescribed by the Act. For example, in the case of salary income, the obligation of the employer to deduct tax at source arises only at the time of payment of salary to the employees. Such tax deducted at source has to be remitted to the credit

of the Central Government through any branch of the RBI, SBI or any authorized bank. If any tax is still due on the basis of return of income, after adjusting advance tax and tax deducted at source, the assessee has to pay such tax (called self-assessment tax) at the time of filing of the return.

1.7 Return of Income

The Income-tax Act, 1961 contains provisions for filing of return of income. Return of income is the format in which the assessee furnishes information as to his total income and tax payable. The format for filing of returns by different assesseees is notified by the CBDT. The particulars of income earned under different heads, gross total income, deductions from gross total income, total income and tax payable by the assessee are required to be furnished in a return of income. In short, a return of income is the declaration of income by the assessee in the prescribed format.

The Act has prescribed due dates for filing return of income in case of different assesseees. All companies and firms have to mandatorily file their return of income before the due date. Individuals and HUFs have to file a return of income if their total income, without giving effect to the deductions under Chapter VIA, exceeds the basic exemption limit.

UNIT – 2 : IMPORTANT DEFINITIONS IN THE INCOME TAX ACT, 1961

Learning Objectives

After studying this unit, you would be able to understand and appreciate –

- the meaning of the important terms used in the Income-tax Act, 1961
- the scope of definition of those terms for the purposes of this Act.

Section 2 gives definitions of the various terms and expressions used therein. In order to understand the provisions of the Act, one must have a thorough knowledge of the meanings of certain key terms like 'person', 'assessee', 'income', etc. To understand the meanings of these terms we have to first check whether they are defined in the Act itself. If a particular definition is given in the Act itself, we have to be guided by that definition. If a particular definition is not given in the Act, reference can be made to the General Clauses Act or dictionaries. Students should note this point carefully because certain terms like "dividend", "transfer", etc. have been given a wider meaning in the Income-tax Act than they are commonly understood.

Some of the important terms defined under section 2 are given below:

2.1 Assessee [Section 2(7)]

Assessee means a person by whom any tax or any other sum of money is payable under this Act. It includes every person in respect of whom any proceeding has been taken for the assessment of his income or assessment of fringe benefits. Sometimes, a person becomes assessable in respect of the income of some other persons. In such a case also, he may be considered as an assessee. This term also includes every person who is deemed to be an assessee or an assessee in default under any provision of this Act.

2.2 Assessment [Section 2(8)]

This is the procedure by which the income of an assessee is determined by the Assessing Officer. It may be by way of a normal assessment or by way of reassessment of an income previously assessed.

2.3 Person [Section 2(31)]

The definition of 'assessee' leads us to the definition of 'person' as the former is closely connected with the latter. The term 'person' is important from another point of view also *viz.*, the charge of income-tax is on every 'person'.

The definition is inclusive i.e. a person includes,

- (i) an individual,
- (ii) a Hindu Undivided Family (HUF),
- (iii) a company,

- (iv) a firm,
- (v) an AOP or a BOI, whether incorporated or not,
- (vi) a local authority, and
- (vii) every artificial juridical person *e.g.*, an idol or deity.

We may briefly consider some of the above seven categories of assessee each of which constitutes a separate unit of assessment.

(i) Individual - The term 'individual' means only a natural person, *i.e.*, a human being. It includes both males and females. It also includes a minor or a person of unsound mind. But the assessment in such a case may be made under section 161(1) on the guardian or manager of the minor or lunatic. In the case of deceased person, assessment would be made on the legal representative.

(ii) HUF - Under the Income-tax Act, 1961, a Hindu undivided family (HUF) is treated as a separate entity for the purpose of assessment. It is included in the definition of the term "person" under section 2(31). The levy of income-tax is on "every person". Therefore, income-tax is payable by a HUF. "Hindu undivided family" has not been defined under the Income-tax Act. The expression is, however, defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and daughters.

The relation of a HUF does not arise from a contract but arises from status. There need not be more than one male member to form a HUF. The Income-tax Act, 1961 also does not indicate that a HUF as an assessable entity must consist of at least two male members.

Some members of the HUF are called co-parceners. They are related to each other and to the head of the family. HUF may contain many members, but members within four degrees including the head of the family (kartha) are called co-parceners. A Hindu Coparcenary includes those persons who acquire an interest in joint family property by birth. Earlier, only male descendants were considered as coparceners. With effect from 6th September, 2005, daughters have also been accorded coparcenary status. It may be noted that only the coparceners have a right to partition.

A daughter of coparcener by birth shall become a coparcener in her own right in the same manner as the son. Being a coparcener, she can claim partition of assets of the family. The rights of a daughter in coparcenary property are equal to that of a son. However, other female members of the family, for example, wife or daughter-in-law of a coparcener are not eligible for such coparcenary rights.

Under the Income-tax Act, 1961, Jain undivided families and Sikh undivided families would also be assessed as a HUF.

Schools of Hindu Law

There are two schools of hindu law. They are –

- (1) Mithakshara school of hindu law
- (2) Dayabhaga school of hindu law

Mithakshara law is followed by entire India except West Bengal and Assam. There is a basic difference between the two schools of thought with regard to succession. Under the Mithakshara law, the inheritance is by birth. One acquires the right to the family property by his birth and not by succession irrespective of the fact that his elders are living. Thus every child born in the family acquires a right/share in the family property.

Dayabagha law prevails in West Bengal and Assam. In Dayabagha law, nobody acquires the right, share in the property by birth as long as the head of family is living, that is, the children do not acquire any right, share in the family property, as long as his father is alive and only on death of the father, the children will acquire right/share in the property. Thus, the father and his brothers would be the coparceners of the HUF

(iii) Company [Section 2(17)] - For all purposes of the Act the term 'Company', has a much wider connotation than that under the Companies Act. Under the Act, the expression 'Company' means:

- (1) any Indian company as defined in section 2(26); or
- (2) any body corporate incorporated by or under the laws of a country outside India, i.e., any foreign company; or
- (3) any institution, association or body which is assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922 or for any assessment year commencing on or before 1.4.1970 under the present Act; or
- (4) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of the CBDT to be a company for such assessment years as may be specified in the CBDT's order.

Classes of Companies

(1) Domestic company [Section 2(22A)] - means an Indian company or any other company which, in respect of its income liable to income-tax, has made the prescribed arrangements for the declaration and payment of dividends (including dividends on preference shares) within India, payable out of such income.

Indian company [Section 2(26)] - Two conditions should be satisfied so that a company can be regarded as an Indian company -

- (a) the company should have been formed and registered under any law relating to companies which was or is in force in any part of India, and
- (b) the registered office or the principal office of the company should be in India.

The expression 'Indian Company' also includes:

- (i) A corporation established by or under a Central, State or Provincial Act (like Financial Corporation or a State Road Transport Corporation),
- (ii) An institution or association or body which is declared by the Board to be a company under section 2(17)(iv) provided its registered or principal office is in India.
- (iii) in the case of the State of Jammu and Kashmir, a company formed and registered under any law for the time being in force in that State.
- (iv) in the case of any of the Union territories of Dadra and Nagar Haveli, Goa, Daman and Diu, and Pondicherry, a company formed and registered under any law for the time being in force in that Union territory.

Company in which public are substantially interested [Section 2(18)] - The following companies are said to be companies in which the public are substantially interested:

- (i) A company owned by the Government (either Central or State but not Foreign) or the Reserve Bank of India (RBI) or in which not less than 40% of the shares are held by the Government or the RBI or corporation owned by that bank.
- (ii) A company which is registered under section 25 of the Companies Act, 1956 (formed for promoting commerce, arts, science, religion, charity or any other useful object).
- (iii) A company having no share capital which is declared by the Board for the specified assessment years to be a company in which the public are substantially interested.
- (iv) A company which is not a private company as defined in the Companies Act, 1956 and which fulfills any of the following conditions:
 - its equity shares should have, as on the last day of the relevant previous year, been listed in a recognised stock exchange in India; or
 - its equity shares carrying at least 50% (40% in case of industrial companies) voting power should have been unconditionally allotted to or acquired by and should have been beneficially held throughout the relevant previous year by (a) Government or (b) a Statutory Corporation or (c) a company in which public are substantially interested or (d) any wholly owned subsidiary of company mentioned in (c).
- (v) A company which carries on its principal business of accepting deposits from its members and which is declared by the Central Government under section 620A of the Companies Act to be Nidhi or a Mutual Benefit Society.
- (vi) A company whose equity shares carrying at least 50% of the voting power have been allotted unconditionally to or acquired unconditionally by and were beneficially held throughout the relevant previous year by one or more co-operative societies.

Person having substantial interest in the company [Section 2(32)] – is a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend), whether with

or without a right to participate in profits, carrying at least 20% of the total voting power.

Note: The main criterion is the 'beneficial' ownership and not 'legal' ownership. Therefore, the registered holder of even the majority of equity shares, would not fall within this definition if he has no beneficial interest in the shares. On the other hand, a person who is beneficially entitled to atleast 20% of the equity share capital of a company would fall within this definition even if he is not the registered holder of any shares.

(2) Foreign company [Section 2(23A)] - Foreign company means a company which is not a domestic company.

(iv) Firm - The terms 'firm', 'partner' and 'partnership' have the same meanings as assigned to them in the Indian Partnership Act. In addition, the definitions also include the terms as they have been defined in the Limited Liability Partnership Act, 2008. However, for income-tax purposes a minor admitted to the benefits of an existing partnership would also be treated as partner. This is specified under section 2(23) of the Act. A partnership is the relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all. The persons who have entered into partnership with one another are called individually 'partners' and collectively a 'firm'.

Note:

- (i) Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 has incorporated the taxation scheme of LLPs in the Income-tax Act, 1961 on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.
- (ii) Consequently, the following definitions in section 2(23) have been amended -
 - (1) The definition of 'partner' to include within its meaning, a partner of a limited liability partnership;
 - (2) The definition of 'firm' to include within its meaning, a limited liability partnership; and
 - (3) The definition of 'partnership' to include within its meaning, a limited liability partnership.

The definition of these terms under the Income-tax Act would, in effect, also include the terms as they have been defined in the Limited Liability Partnership Act, 2008. Section 2(q) of the LLP Act, 2008 defines a 'partner' as any person who becomes a partner in the LLP in accordance with the LLP agreement. An LLP agreement has been defined under section 2(o) to mean any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to the LLP.

(v) **Association of Persons (AOP)** - When persons combine together for promotion of joint enterprise they are assessable as an AOP when they do not in law constitute a partnership. In order to constitute an association, persons must join in a common purpose, common action and their object must be to produce income; it is not enough that the persons receive the income jointly. Co-heirs, co-legatees or co-donees joining together for a common purpose or action would be chargeable as an AOP.

Body of Individuals (BOI) – It denotes the status of persons like executors or trustees who merely receive the income jointly and who may be assessable in like manner and to the same extent as the beneficiaries individually. Thus co-executors or co-trustees are assessable as a BOI as their title and interest are indivisible. Income-tax shall not be payable by an assessee in respect of the receipt of share of income by him from BOI and on which the tax has already been paid by such BOI.

(vi) **Local Authority** - The term means a municipal committee, district board, body of port commissioners or other authority legally entitled to or entrusted by the Government with the control or management of a municipal or local fund.

Note : A local authority is taxable in respect of that part of its income which arises from any business carried on by it in so far as that income does not arise from the supply of a commodity or service within its own jurisdictional area. However, income arising from the supply of water and electricity even outside the local authority's own jurisdictional areas is exempt from tax.

(vii) **Artificial Persons** - This category could cover every artificial juridical person not falling under other heads. An idol, or deity would be assessable in the status of an artificial juridical person.

2.4 Income [Section 2(24)]

Section 2(24) of the Act gives a statutory definition of income. This definition is inclusive and not exhaustive. Thus, it gives scope to include more items in the definition of income as circumstances may warrant. At present, the following items of receipts are included in income:—

- (1) Profits and gains.
- (2) Dividends.
- (3) Voluntary contributions received by a trust/institution created wholly or partly for charitable or religious purposes or by an association or institution referred to in section 10(21) or section (23C)(iiiad)/(iii ae)/(iv)/(v)/(vi)/(via) or an electoral trust –

Research association approved under section 35(1)(ii)	10(21)
Universities and other educational institutions	10(23C)(iiiad)/(vi)
Hospitals and other medical institutions	10(23C) (iii ae)/(via)
Notified funds or institutions established for charitable purposes	10(23C)(iv)
Notified trusts or institutions established wholly for public religious purposes or wholly for public religious and charitable purposes	10(23C)(v)
Electoral trust	13B

- (4) The value of any perquisite or profit in lieu of salary taxable under section 17.
- (5) Any special allowance or benefit other than the perquisite included above, specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.
- (6) Any allowance granted to the assessee to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.
- (7) The value of any benefit or perquisite whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company or by a relative of the director or such person and any sum paid by any such company in respect of any obligation which, but for such payment would have been payable by the director or other person aforesaid.
- (8) The value of any benefit or perquisite, whether convertible into money or not, which is obtained by any representative assessee mentioned under section 160(1)(iii) and (iv), or by any beneficiary or any amount paid by the representative assessee for the benefit of the beneficiary which the beneficiary would have ordinarily been required to pay.
- (9) Deemed profits chargeable to tax under section 41 or section 59.
- (10) Profits and gains of business or profession chargeable to tax under section 28.
- (11) Any capital gains chargeable under section 45.
- (12) The profits and gains of any insurance business carried on by Mutual Insurance Company or by a cooperative society, computed in accordance with Section 44 or any surplus taken to be such profits and gains by virtue of the provisions contained in the first Schedule to the Act.
- (13) The profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members.
- (14) Any winnings from lotteries, cross-word puzzles, races including horse races, card games and other games of any sort or from gambling, or betting of any form or nature whatsoever. For this purpose,
 - (i) "Lottery" includes winnings, from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;
 - (ii) "Card game and other game of any sort" includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game.

- (15) Any sum received by the assessee from his employees as contributions to any provident fund (PF) or superannuation fund or Employees State Insurance Fund (ESI) or any other fund for the welfare of such employees.
- (16) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy will constitute income.
- “Keyman insurance policy” means a life insurance policy taken by a person on the life of another person where the latter is or was an employee or is or was connected in any manner whatsoever with the former’s business.
- (17) Any sum referred to clause (va) of section 28. Thus, any sum, whether received or receivable in cash or kind, under an agreement for not carrying out any activity in relation to any business; or not sharing any know-how, patent, copy right, trade-mark, licence, franchise, or any other business or commercial right of a similar nature, or information or technique likely to assist in the manufacture or processing of goods or provision of services, shall be chargeable to income tax under the head “profits and gains of business or profession”.
- (18) Any sum of money or value of property referred to in section 56(2)(vii) or section 56(2)(viii) [*Refer to Unit 5 of Chapter 4 “Income from Other Sources”*].
- (19) Any consideration received for issue of shares as exceeds the fair market value of the shares referred to in section 56(2)(viib) [*Refer to Unit 5 of Chapter 4 “Income from Other Sources”*].
- (20) **Any sum of money referred to in section 56(2)(ix)** [*Refer to Unit 5 of Chapter 4 “Income from Other Sources”*].

Students should carefully study the various items of receipts included in the above definition. Some of them like capital gains are not revenue receipts. However, since they have been included in the definition, they are chargeable as income under the Act. The concept of revenue and capital receipts is discussed hereunder –

The Act contemplates a levy of tax on income and not on capital and hence it is very essential to distinguish between capital and revenue receipts. Capital receipts cannot be taxed, unless they fall within the scope of the definition of “income” and so the distinction between capital and revenue receipts is material for tax purposes.

Certain capital receipts which have been specifically included in the definition of income are compensation for modification or termination of services, income by way of capital gains etc.

It is not possible to lay down any single test as infallible or any single criterion as decisive, final and universal in application to determine whether a particular receipt is capital or revenue in nature. Hence, the capital or revenue nature of the receipt must be determined with reference to the facts and circumstances of each case.

Distinction between capital and revenue receipts: The following are some of the important criteria which may be applied to distinguish between capital and revenue receipts.

(1) A receipt referable to fixed capital would be a capital receipt whereas a receipt referable to circulating capital would be a revenue receipt. The former is not taxable while the latter is taxable. Tangible and intangible assets which the owner keeps in his possession for making profits are in the nature of fixed capital. The circulating capital is one which is turned over and yields income or loss in the process.

(2) Profits arising from the sale of a capital asset are chargeable to tax as capital gains under section 45 whereas profits arising from the sale of a trading asset being of revenue nature are taxable as income from business under section 28 provided that the sale is in the regular course of assessee's business or the transaction constitutes an adventure in the nature of trade.

(3) Profits arising from transactions which are entered into in the course of the business regularly carried on by the assessee, or are incidental to, or associated with the business of the assessee would be revenue receipts chargeable to tax. For example, a banker's or financier's dealings in foreign exchange or sale of shares and securities, a shipbroker's purchases of ship in his own name, a share broker's purchase of shares on his own account would constitute transactions entered and yielding income in the ordinary course of their business. Whereas building and land would constitute capital assets in the hands of a trader in shares, the same would constitute stock-in-trade in the hands of a property dealer.

(4) In the case of profit arising from the sale of shares and securities the nature of the profit has to be ascertained from the motive, intention or purpose with which they were bought. If the shares were acquired as an investor or with a view to acquiring a controlling interest or for obtaining a managing or selling agency or a directorship the profit or loss on their sale would be of a capital nature; but if the shares were acquired in the ordinary course of business as a dealer in shares, it would constitute his stock-in-trade. If the shares were acquired with speculative motive the profit or loss (although of a revenue nature) would have to be dealt with separately from other business.

(5) Even a single transaction may constitute a business or an adventure in the nature of trade even if it is outside the normal course of the assessee's business. Repetition of such transactions is not necessary. Thus, a bulk purchase followed by a bulk sale or a series of retail sales or bulk sale followed by a series of retail purchases would constitute an adventure in the nature of trade and consequently the income arising therefrom would be taxable. Purchase of any article with no intention to resell it, but resold under changed circumstances would be a transaction of a capital nature and capital gains arise. However, where an asset is purchased with the intention to resell it, the question whether the profit on sale is capital or revenue in nature depends upon (i) the conduct of the assessee, (ii) the nature and quantity of the article purchased, (iii) the nature of the operations involved, (iv) whether the venture is on capital or revenue account, and (v) other related circumstances of the case.

(6) In case of annuities, there is a need to distinguish whether the agreement is for payment of a debt by installments or for making annual payments by way of income. Where capital is repaid in installments, it is not liable to tax. In other cases, it is revenue in nature. An annuity

received from an employer or former employer is taxable as "Income from salaries" whereas an annuity received from a person other than employer under an insurance policy or other contract or under the terms of a deed is taxable under the head "Income from other sources".

(7) Receipt of liquidated damages directly and intimately linked with the procurement of a capital asset, which lead to delay in coming into existence of the profit-making apparatus, is a capital receipt. The amount received by the assessee towards compensation for sterilization of the profit earning source is not in the ordinary course of business. Hence, it is a capital receipt in the hands of the assessee.

(8) Where an assessee receives compensation of termination of the agency business being the only source of income the receipt is a capital nature, but taxable under section 28(ii)(c). However, where the assessee has a number of agencies and one of them is terminated and compensation received therefore, the receipt would be of a revenue nature since taking agencies and exploiting the same for earning income is the ordinary course of business and the loss of one agency would be made good by taking another. Compensation received from the employer for premature termination of the service contract is a capital receipt, but is taxable as profit in lieu of salary under section 17(3).

(8) In case of subsidies, the object for which the subsidy determines the nature of the subsidy and not the form or the mechanism through which subsidy is given. If the object of the subsidy is to enable the assessee to run the business more profitably, the receipt is a revenue receipt. On the other hand, if the object of the assistance is to enable the assessee to set up a new unit or to expand an existing unit, the receipt would be a capital receipt.

(9) Normally, gifts constitute capital receipts in the hands of the recipient. However, certain gifts are brought within the purview of income-tax, for example, receipt of property without consideration is brought to tax under section 56(2).

For example, any sum of money or value of property received without consideration or for inadequate consideration by an individual or a HUF from any person, other than a relative, is chargeable under the head "Income from Other Sources" [For details, refer to Unit – 5 of Chapter 4 on "Income from Other Sources"].

2.5 Dividend [Section 2(22)]

The term 'dividend' as used in the Act has a wider scope and meaning than under the general law. According to section 2(22), the following receipts are deemed to be dividend:

(a) **Distribution of accumulated profits, entailing the release of company's assets** - Any distribution of accumulated profits, whether capitalised or not, by a company to its shareholders is dividend if it entails the release of all or any part of its assets. For example, if accumulated profits are distributed in cash it is dividend in the hands of the shareholders. Where accumulated profits are distributed in kind, for example by delivery of shares etc. entailing the release of company's assets, the market value of such shares on the date of such distribution is deemed dividend in the hands of the shareholder.

(b) Distribution of debentures, deposit certificates and bonus shares to preference shareholders - Any distribution to its shareholders by a company of debenture stock or deposit certificate in any form, whether with or without interest, and any distribution of bonus shares to preference shareholders to the extent to which the company possesses accumulated profits, whether capitalised or not, will be deemed as dividend. The market value of such bonus shares is taxable in the hands of the preference shareholder. In the case of debentures, debenture stock etc., their value is to be taken at the market rate and if there is no market rate they should be valued according to accepted principles of valuation.

Note: Bonus shares given to equity shareholders are not treated as dividend.

(c) Distribution on liquidation - Any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not, is deemed to be dividend income.

Note: Any distribution made out of the profits of the company after the date of the liquidation cannot amount to dividend. It is a repayment towards capital.

Accumulated profits include all profits of the company up to the date of liquidation whether capitalised or not. But where liquidation is consequent to the compulsory acquisition of an undertaking by the Government or by any corporation owned or controlled by the Government, the accumulated profits do not include any profits of the company prior to the 3 successive previous years immediately preceding the previous year in which such acquisition took place subject to certain exceptions.

(d) Distribution on reduction of capital - Any distribution to its shareholders by a company on the reduction of its capital to the extent to which the company possessed accumulated profits, whether capitalised or not, shall be deemed to be dividend.

Exception - The same exceptions as given in case (c) above shall also apply in this case.

(e) Advance or loan by a closely held company to its shareholder - Any payment by a company in which the public are not substantially interested of any sum by way of advance or loan to any shareholder who is the beneficial owner of 10% or more of the equity capital of the company will be deemed to be dividend to the extent of the accumulated profits. If the loan is not covered by the accumulated profits, it is not deemed to be dividend.

There are two exceptions to this rule:

- (i) If the loan is granted in the ordinary course of its business and lending of money is a substantial part of the company's business, the loan or advance to a shareholder is not deemed to be dividend.
- (ii) Where a loan had been treated as dividend and subsequently the company declares and distributes dividend to all its shareholders including the borrowing shareholder, and the dividend so paid is set off by the company against the previous borrowing, the adjusted amount will not be again be treated as a dividend.

Advance or loan by a closely held company to a specified concern - Any payment by a company in which the public are not substantially interested to any concern (i.e. HUF / Firm / AOP / BOI / Company) in which a shareholder, having the beneficial ownership of atleast 10% of the equity shares is a member or a partner and in which he has a substantial interest (i.e. atleast 20% share of the income of the concern). The dividend income shall be taxable in the hands of the concern. Also, any payments by such a closely held company on behalf of, or for the individual benefit of any such shareholder will also be deemed to be dividend. However, in both cases the ceiling limit of dividend is the extent of accumulated profits.

Illustration : Suppose Mr. X is a shareholder in a Company A as well as Company B. He has 10% shareholding in Company A and 20% shareholding in Company B. The accumulated profits of Company A = ₹ 10 lakh. A loan of ₹ 12 lakh is given by Company A to Company B. This loan up to the extent of accumulated profits of ₹ 10 lakh is treated as dividend and is taxable in the hands of Company B.

Other exceptions

Apart from the exceptions cited above, the following also do not constitute "dividend" -

- (i) Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956;
- (ii) any distribution of shares on demerger by the resulting companies to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

Basis of charge of dividend: Any income by way of dividends, referred to under section 115-O, is excluded from the total income of the shareholder [Section 10(34)]. Under section 115-O, any dividend declared, distributed or paid by a domestic company, whether out of current or accumulated profits, shall be charged to additional income-tax at a flat rate of 15% in addition to normal income-tax chargeable on the income of the company. This is known as corporate dividend tax. Corporate dividend tax is not leviable on deemed dividend under section 2(22)(e). Hence, the same will be taxed in the hands of the shareholder.

Dividends received from a company, other than a domestic company, are still liable to tax in the hands of the shareholder. For example, dividend received from a foreign company is liable to tax in the hands of the shareholder.

Year of accrual of dividend : Section 8 provides that deemed dividend under section 2(22) declared by a company or distributed or paid by it shall be deemed to be the income of the previous year in which it is declared, distributed or paid, as the case may be. Any interim dividend shall be deemed to be the income of the previous year in which the amount is unconditionally made available to the member who is entitled to it.

2.6 India [Section 2(25A)]

The term 'India' means –

- (i) the territory of India as per article 1 of the Constitution,

- (ii) its territorial waters, seabed and subsoil underlying such waters,
- (iii) continental shelf,
- (iv) exclusive economic zone or
- (v) any other specified maritime zone and the air space above its territory and territorial waters.

Specified maritime zone means the maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976.

2.7 Infrastructure Capital Company [Section 2(26A)]

"Infrastructure capital company" means such company which makes investments by way of acquiring shares or providing long-term finance to -

- (1) any enterprise or undertaking wholly engaged -
 - (a) in the business referred to in section 80-IA(4) i.e. business of
 - (i) developing/operating and maintaining/developing, operating and maintaining any infrastructure facility fulfilling the specified conditions
 - (ii) providing telecom services, whether basic or cellular
 - (iii) developing, developing and operating or maintaining and operating an industrial park or special economic zone notified by the Central Government
 - (iv) generating, transmitting or distributing power or undertaking substantial renovation and modernization of the existing network of transmission or distribution lines.
 - (b) in the business referred to in section 80-IAB(1) i.e. any business of developing a SEZ.
- (2) an undertaking developing and building a housing project referred to in section 80-IB(10) i.e. approved before 31.3.2007 by a local authority and commences or commenced development and construction on or after 1.10.98 and completes or completed development and construction within the time specified.
- (3) a project for constructing a hotel of not less than three-star category as classified by the Central Government or
- (4) a project for constructing a hospital with at least 100 beds for patients.

2.8 Infrastructure Capital Fund [Section 2(26B)]

Infrastructure capital fund means such fund operating under a trust deed registered under the provisions of the Registration Act, 1908 established to raise monies by the trustees for investment by way of acquiring shares or providing long-term finance to -

- (1) any enterprise or undertaking wholly engaged in the business referred to in section 80-IA(4) or section 80-IAB(1); or

- (2) an undertaking developing and building a housing project referred to in section 80-IB(10); or
- (3) a project for constructing a hotel of not less than three star category as classified by the Central Government; or
- (4) a project for constructing a hospital with at least 100 beds for patients.

2.9 Manufacture [Section 2(29BA)]

'Manufacture', with its grammatical variations, shall mean a change in a non-living physical object or article or thing,—

- (a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or
- (b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.

UNIT – 3 : BASIS OF CHARGE AND RATES OF TAXES**Learning Objectives**

After studying this unit, you would be able to –

- ◆ understand the basis of charge of income-tax
- ◆ know the rates of taxes applicable for different classes of assessees
- ◆ know whether surcharge is applicable to a particular class of assessee and if so, the rate of surcharge and the level of income above which the same is applicable
- ◆ understand the concept of marginal relief
- ◆ know about the levy of education cess and secondary and higher education cess.

3.1 Charge of Income-Tax

Section 4 of the Income-tax Act, 1961 is the charging section which provides that:

- (i) Tax shall be charged at the rates prescribed for the year by the annual Finance Act.
- (ii) The charge is on every person specified under section 2(31);
- (iii) Tax is chargeable on the total income earned during the previous year and not the assessment year. (There are certain exceptions provided by sections 172, 174, 174A, 175 and 176);
- (iv) Tax shall be levied in accordance with and subject to the various provisions contained in the Act.

This section is the back bone of the law of income-tax in so far as it serves as the most operative provision of the Act. The tax liability of a person springs from this section.

3.2 Rates of Tax

Income-tax is to be charged at the rates fixed for the year by the annual Finance Act. Section 2 of the Finance (No. 2) Act, 2014 read with Part I of the First Schedule to the Finance (No.2) Act, 2014 specifies the rates at which income-tax is to be levied on income chargeable to tax for the A.Y.2014-15. Part II lays down the rate at which tax is to be deducted at source during the financial year 2014-15 from income subject to such deduction under the Act; Part III lays down the rates for charging income-tax in certain cases, rates for deducting income-tax from income chargeable under the head "Salaries" and the rates for computing advance tax for the financial year 2014-15. Part III of the First Schedule to the Finance (No. 2) Act, 2014 will become Part I of the First Schedule to the Finance Act, 2015 and so on.

The slab rates applicable for A.Y.2015-16 are as follows:

(1) Individual / Hindu Undivided Family (HUF) / Association of Persons (AOP) / Body of Individuals (BOI) / Artificial Juridical Person.

- | | |
|---|--|
| (i) where the total income does not exceed ₹ 2,50,000 | Nil; |
| (ii) where the total income exceeds ₹ 2,50,000 but does not exceed ₹ 5,00,000 | 10% of the amount by which the total income exceeds ₹ 2,50,000 |
| (iii) where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000 | ₹ 25,000 plus 20% of the amount by which the total income exceeds ₹ 5,00,000; |
| (iv) where the total income exceeds ₹ 10,00,000 | ₹ 1,25,000 plus 30% of the amount by which the total income exceeds ₹ 10,00,000. |

Illustration: Mr. X has a total income of ₹ 12,00,000. Compute his gross tax liability.

Tax liability = ₹ 1,25,000 + 30% of ₹ 2,00,000 = ₹ 1,85,000

Alternatively:

Tax liability :

First ₹ 2,50,000	- Nil
Next ₹ 2,50,000 – ₹ 5,00,000	- @ 10% of ₹ 2,50,000 = ₹ 25,000
Next ₹ 5,00,000 – ₹ 10,00,000	- @ 20% of ₹ 5,00,000 = ₹ 1,00,000
Balance i.e. ₹ 12,00,000 – ₹ 10,00,000	- @ 30% of ₹ 2,00,000 = ₹ 60,000
	Total tax = ₹ 1,85,000

It is to be noted that for a senior citizen (being a resident individual who is of the age of 60 years but not more than 80 years at any time during the previous year), the basic exemption limit is ₹ 3,00,000. Further, resident individuals of the age of 80 years or more at any time during the previous year, being very senior citizens, would be eligible for a higher basic exemption limit of ₹ 5,00,000.

Therefore, the tax slabs for these assesseees would be as follows –

For senior citizens (being resident individuals of the age of 60 years or more but less than 80 years)

- | | |
|---|---|
| (i) where the total income does not exceed ₹ 3,00,000 | Nil; |
| (ii) where the total income exceeds ₹ 3,00,000 but does not exceed ₹ 5,00,000 | 10% of the amount by which the total income exceeds ₹ 3,00,000; |
| (iii) where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000 | ₹ 20,000 plus 20% of the amount by which the total income exceeds ₹ 5,00,000; |

1.26 Income-tax

- (iv) where the total income exceeds ₹ 10,00,000 ₹ 1,20,000 plus 30% of the amount by which the total income exceeds ₹ 10,00,000.

For resident individuals of the age of 80 years or more at any time during the previous year

- (i) where the total income does not exceed Nil;
₹ 5,00,000
- (ii) where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000 20% of the amount by which the total income exceeds ₹ 5,00,000;
- (iv) where the total income exceeds ₹ 10,00,000 ₹ 1,00,000 plus 30% of the amount by which the total income exceeds ₹ 10,00,000.

(2) Firm/LLP

On the whole of the total income 30%

(3) Local authority

On the whole of the total income 30%

(4) Co-operative Society

- (i) Where the total income does not exceed ₹ 10,000 10% of the total income
- (ii) Where the total income exceeds ₹ 10,000 but does not exceed ₹ 20,000 ₹ 1,000 plus 20% of the amount by which the total income exceeds ₹ 10,000
- (iii) Where the total income exceeds ₹ 20,000 ₹ 3,000 plus 30% of the amount by which the total income exceeds ₹ 20,000

(5) Company

- (i) In the case of a domestic company 30% of the total income
- (ii) In the case of a company other than a domestic company 40% on the total income
- However, specified royalties and fees for rendering technical services (FTS) received from Government or an Indian concern in pursuance of an approved agreement made by the company with the Government or Indian concern between 1.4.1961 and 31.3.1976 (in case of royalties) and between 1.3.1964 and 31.3.1976 (in case of FTS) would be chargeable to tax @50%.

The above rates are prescribed by the Finance (No.2) Act, 2014. However, in respect of certain types of income, as mentioned below, the Income-tax Act, 1961 has prescribed specific rates–

- (1) Section 112 has prescribed the rate of tax @20% in respect of long term capital gains. In case of non-corporate non-residents and foreign companies (For details, refer Unit 4 of Chapter 4 on "Capital gains")
- (2) Section 111A provides for a concessional rate of tax (i.e. 15%) on the short-term capital gains on transfer of -
 - (i) an equity share in a company or
 - (ii) a unit of an equity oriented fund or
 - (iii) a unit of a business trust**

The conditions for availing the benefit of this concessional rate are –

 - (i) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004 and
 - (ii) such transaction should be chargeable to securities transaction tax.
- (3) Section 115BB prescribes the rate of tax @30% for winnings from-
 - (i) any lottery; or
 - (ii) crossword puzzle; or
 - (iii) race including horse race; or
 - (iv) card game and other game of any sort; or
 - (v) gambling or betting of any form.

Surcharge

The rates of surcharge applicable for A.Y.2015-16 are as follows:

- (i) **Individual/HUF/AOP/BOI/Artificial juridical person/Co-operative societies/Local Authorities/Firms/LLPs**

Where the total income exceeds ₹ 1 crore, surcharge is payable at the rate of 10% of income-tax computed in accordance with the provisions of para (1)/(2)/(3)/(4) above or section 111A or section 112.

Marginal relief is available in case of such persons having a total income exceeding ₹ 1 crore i.e., the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹ 1 crore should not be more than the amount of income exceeding ₹ 1 crore.

- (ii) **Domestic company**

- (a) **In case of a domestic company, whose total income > ₹ 1 crore but is ≤ ₹ 10 crore**

Where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, surcharge is payable at the rate of 5% of income-tax computed in accordance with

the provisions of para (5)(i) above or section 111A or section 112. Marginal relief is available in case of such companies i.e. the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹ 1 crore should not be more than the amount of income exceeding ₹ 1 crore.

Example 1

Compute the tax liability of X Ltd., a domestic company, assuming that the total income of X Ltd. is ₹ 1,01,00,000 and the total income does not include any income in the nature of capital gains.

Answer

The tax payable on total income of ₹ 1,01,00,000 of X Ltd. computed@ 31.5% (including surcharge@5%) is ₹ 31,81,500. However, the tax cannot exceed the tax of ₹ 30,00,000 payable on total income of ₹ 1 crore by more than ₹ 1,00,000, being the amount of total income exceeding ₹ 1 crore. Therefore, the tax payable on ₹ 1,01,00,000 would be ₹ 31,00,000 (₹ 30,00,000 + ₹ 1,00,000). The marginal relief is ₹ 81,500 (i.e., ₹ 31,81,500 - ₹ 31,00,000).

(b) In case of a domestic company, whose total income is > ₹ 10 crore

Where the total income exceeds ₹ 10 crore, surcharge is payable at the rate of 10% of income-tax computed in accordance with the provisions of para (5)(i) above or section 111A or section 112.

Marginal relief is available in case of such companies i.e. the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹ 10 crore should not be more than the amount of income exceeding ₹ 10 crore.

Example 2

Compute the tax liability of X Ltd., a domestic company, assuming that the total income of X Ltd. is ₹ 10,01,00,000 and the total income does not include any income in the nature of capital gains.

Answer

The tax payable on total income of ₹ 10,01,00,000 of X Ltd. computed@ 33% (including surcharge@10%) is ₹ 3,30,33,000. However, the tax cannot exceed the tax of ₹ 3,15,00,000 (31.5% of ₹ 10 crore) payable on total income of ₹ 10 crore by more than ₹ 1,00,000, being the amount of total income exceeding ₹ 10 crore. Therefore, the tax payable on ₹ 10,01,00,000 would be ₹ 3,16,00,000 (₹ 3,15,00,000 + ₹ 1,00,000). The marginal relief is ₹ 14,33,000 (i.e., ₹ 3,30,33,000 - ₹ 3,16,00,000).

(iii) Foreign company**(a) In case of a foreign company, whose total income > ₹ 1 crore but is ≤ ₹ 10 crore**

Where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, surcharge is payable at the rate of 2% of income-tax computed in accordance with

the provisions of paragraph (5)(ii) above or section 111A or section 112. Marginal relief is available in case of such companies i.e., the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹ 1 crore should not be more than the amount of income exceeding ₹ 1 crore.

(b) In case of a foreign company, whose total income is > ₹ 10 crore

Where the total income exceeds ₹ 10 crore, surcharge is payable at the rate of 5% of income-tax computed in accordance with the provisions of para (5)(ii) above or section 111A or section 112.

Marginal relief is available in case of such companies i.e. the additional amount of income-tax payable (together with surcharge) on the excess of income over ₹ 10 crore should not be more than the amount of income exceeding ₹ 10 crore.

Rebate of up to ₹ 2,000 for resident individuals having total income of up to ₹ 5 lakh [Section 87A]

In order to provide tax relief to the individual tax payers who are in the 10% tax slab, section 87A has been inserted to provide a rebate from the tax payable by an assessee, being an individual resident in India, whose total income does not exceed ₹ 5,00,000.

- (i) The rebate shall be equal to the amount of income-tax payable on the total income for any assessment year or an amount of ₹ 2,000, whichever is less.
- (ii) Consequently, any individual having total income up to ₹ 2,20,000 will not be required to pay any tax. Further, every individual having total income above ₹ 2,20,000 but not exceeding ₹ 5,00,000 shall get a tax relief of ₹ 2,000. In effect, the rebate would be the tax payable or ₹ 2,000, whichever is less.
- (iii) Further, the aggregate amount of rebate under section 87A shall not exceed the amount of income-tax (as computed before allowing such rebate) on the total income of the assessee with which he is chargeable for any assessment year.

“Education cess” and “Secondary and Higher education cess” on income-tax: The amount of income-tax as increased by the union surcharge, if applicable, should be further increased by an additional surcharge called the “Education cess on income-tax”, calculated at the rate of 2% of such income-tax and surcharge, if applicable. Education cess is leviable in the case of all assesseees i.e. individuals, HUF, AOP / BOI, firms, local authorities, co-operative societies and companies. Further, “Secondary and higher education cess on income-tax” @1% of income-tax plus surcharge, if applicable, is leviable to fulfill the commitment of the Government to provide and finance secondary and higher education.

UNIT – 4 : CONCEPT OF PREVIOUS YEAR AND ASSESSMENT YEAR

Learning Objectives

After studying this unit, you would be able to understand –

- ◆ the meaning and relevance of assessment year and previous year
- ◆ what is the previous year for undisclosed sources of income
- ◆ circumstances when income of the previous year would be assessed to tax in the previous year itself.

4.1 Meaning of Assessment Year And Previous Year

(i) **Assessment year** - The term has been defined under section 2(9). This means a period of 12 months commencing on 1st April every year. The year in which tax is paid is called the assessment year while the year in respect of the income of which the tax is levied is called the previous year. *For example, for the assessment year 2015-16, the relevant previous year is 2014-15 (1.4.2014 to 31.3.2015).*

(ii) **Previous year [Section 3]** – It means the financial year immediately preceding the assessment year. The income earned during the previous year is taxed in the assessment year.

Business or profession newly set up during the financial year - In such a case, the previous year shall be the period beginning on the date of setting up of the business or profession and ending with 31st March of the said financial year.

If a source of income comes into existence in the said financial year, then the previous year will commence from the date on which the source of income newly comes into existence and will end with 31st March of the financial year.

Illustration:

1. *A is running a business from 1993 onwards. Determine the previous year for the assessment year 2015-16.*

Ans. The previous year will be 1.4.2014 to 31.3.2015.

2. *A chartered accountant sets up his profession on 1st July, 2014. Determine the previous year for the assessment year 2015-16.*

Ans. The previous year will be from 1.7.2014 to 31.3.2015.

4.2 Previous year for undisclosed sources of income

There are many occasions when the Assessing Officer detects cash credits, unexplained investments, unexplained expenditure etc, the source for which is not satisfactorily explained by the assessee to the Assessing Officer. The Act contains a series of provisions to provide for these contingencies:

(i) **Cash Credits [Section 68]:** Where any sum is found credited in the books of the assessee and the assessee offers no explanation about the nature and source or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the sum so credited may be charged as income of the assessee of that previous year.

Further, any explanation offered by a closely held company in respect of any sum credited as share application money, share capital, share premium or such amount, by whatever name called, in the accounts of such company shall be deemed to be not satisfactory unless the person, being a resident, in whose name such credit is recorded in the books of such company also explains, to the satisfaction of the Assessing Officer, the source of sum so credited as share application money, share capital, etc. in his hands. Otherwise, the explanation offered by the assessee-company shall be deemed as not satisfactory, consequent to which the sum shall be treated as income of the company. However, this deeming provision would not apply if the person in whose name such sum is recorded in the books of the closely held company is a Venture Capital Fund (VCF) or a Venture Capital Company (VCC) registered with SEBI.

(ii) **Unexplained Investments [Section 69]:** Where in the financial year immediately preceding the assessment year, the assessee has made investments which are not recorded in the books of account and the assessee offers no explanation about the nature and the source of investments or the explanation offered is not satisfactory, the value of the investments are taxed as income of the assessee of such financial year.

(iii) **Unexplained money etc. [Section 69A]:** Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and the same is not recorded in the books of account and the assessee offers no explanation about the nature and source of acquisition of such money, bullion etc. or the explanation offered is not satisfactory, the money and the value of bullion etc. may be deemed to be the income of the assessee for such financial year. Ownership is important and mere possession is not enough.

(iv) **Amount of investments etc., not fully disclosed in the books of account [Section 69B]:** Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article and the Assessing Officer finds that the amount spent on making such investments or in acquiring such articles exceeds the amount recorded in the books of account maintained by the assessee and he offers no explanation for the difference or the explanation offered is unsatisfactory, such excess may be deemed to be the income of the assessee for such financial year.

For example, if the assessee is found to be the owner of say 300 gms of gold (market value of which is ₹ 25,000) during the financial year ending 31.3.2015 but he has recorded to have spent ₹ 15,000 in acquiring it, the Assessing Officer can add ₹ 10,000 (i.e. the difference of the market value of such gold and ₹ 15,000) as the income of the assessee, if the assessee offers no satisfactory explanation thereof.

(v) **Unexplained expenditure [Section 69C]:** Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or

the explanation is unsatisfactory the Assessing Officer can treat such unexplained expenditure as the income of the assessee for such financial year. Such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as deduction under any head of income.

(vi) Amount borrowed or repaid on hundi [Section 69D]: Where any amount is borrowed on a hundi or any amount due thereon is repaid other than through an account-payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying for the previous year in which the amount was borrowed or repaid, as the case may be.

However, where any amount borrowed on a hundi has been deemed to be the income of any person, he will not be again liable to be assessed in respect of such amount on repayment of such amount. The amount repaid shall include interest paid on the amount borrowed.

Unexplained money, investments etc. to attract tax @30% [Section 115BBE]

- (i) In order to control laundering of unaccounted money by availing the benefit of basic exemption limit, the unexplained money, investment, expenditure, etc. deemed as income under section 68 or section 69 or section 69A or section 69B or section 69C or section 69D would be taxed at the rate of 30%.
- (ii) No basic exemption or allowance or expenditure shall be allowed to the assessee under any provision of the Income-tax Act, 1961 in computing such deemed income.

4.3 Certain cases when income of a previous year will be assessed in the previous year itself

The income of an assessee for a previous year is charged to income-tax in the assessment year following the previous year. However, in a few cases, this rule does not apply and the income is taxed in the previous year in which it is earned. These exceptions have been made to protect the interests of revenue. The exceptions are as follows:

(i) Shipping business of non-resident [Section 172] - Where a ship, belonging to or chartered by a non-resident, carries passengers, livestock, mail or goods shipped at a port in India, the ship is allowed to leave the port only when the tax has been paid or satisfactory arrangement has been made for payment thereof. 7.5% of the freight paid or payable to the owner or the charterer or to any person on his behalf, whether in India or outside India on account of such carriage is deemed to be his income which is charged to tax in the same year in which it is earned.

(ii) Persons leaving India [Section 174] - Where it appears to the Assessing Officer that any individual may leave India during the current assessment year or shortly after its expiry and he has no present intention of returning to India, the total income of such individual for the period from the expiry of the respective previous year up to the probable date of his departure from India is chargeable to tax in that assessment year.

Example: Suppose Mr. X is leaving India for USA on 10.6.2015 and it appears to the Assessing Officer that he has no intention to return. Before leaving India, Mr. X will be required to pay income tax on the income earned during the P.Y. 2014-15 as well as the total income earned during the period 1.4.2015 to 10.06.2015.

(iii) **AOP / BOI / Artificial Juridical Person formed for a particular event or purpose [Section 174A]** - If an AOP/BOI etc. is formed or established for a particular event or purpose and the Assessing Officer apprehends that the AOP/BOI is likely to be dissolved in the same year or in the next year, he can make assessment of the income up to the date of dissolution as income of the relevant assessment year.

(iv) **Persons likely to transfer property to avoid tax [Section 175]** - During the current assessment year, if it appears to the Assessing Officer that a person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets to avoid payment of any liability under this Act, the total income of such person for the period from the expiry of the previous year to the date, when the Assessing Officer commences proceedings under this section is chargeable to tax in that assessment year.

(v) **Discontinued business [Section 176]** - Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year up to the date of such discontinuance may, at the discretion of the Assessing Officer, be charged to tax in that assessment year.